THE LEGISLATIVE ASSEMBLY OF BRITISH COLUMBIA

GOVERNMENT FINANCIAL ACCOUNTABILITY FOR THE 1997/98 FISCAL YEAR

SELECT STANDING COMMITTEE ON PUBLIC ACCOUNTS REPORT

DOC
BC
ZA
D:P8
R4
2000
1st
c.3

LEGISLATIVE LIBRARY OF BRITISH COLUMBIA
3 3298 00240 7618

THE LEGISLATIVE ASSEMBLY OF
BRITISH COLUMBIA

Government Financial Accountability for the 1997/98 Fiscal Year

Select Standing Committee on
Public Accounts
Report

LEGISLATIVE LIBRARY
VICTORIA, BC V8V 1X4

April 18, 2000

To the Honourable,
The Legislative Assembly of
the Province of British Columbia
Victoria, British Columbia
Honourable Members:

We have the honour to present the *First Report* of the Select Standing Committee on Public Accounts for the Fourth Session of the Thirty-Sixth Parliament.

This *First Report* covers the work of the Committee on the matter of **Government Financial Accountability for the 1997/98 Fiscal Year**.
Respectfully submitted on behalf of the Committee.

Mr. Rick Thorpe, MLA
Chair

Ms. Evelyn Gillespie, MLA
Deputy Chair

Table of Contents

Composition Of The Committee 1

Terms Of Reference 3

Part 1 – Report On The 1997/98 Public Accounts 5

Part 2 – Report On The Province's Financial Management 17

Part 3 – Report On The Province's Financial Systems And Controls 29

Appendices

I – SUMMARY OF COMMITTEE RECOMMENDATIONS 43

II – WRITTEN SUBMISSIONS/CORRESPONDENCE 45

Composition of the Committee

Members

Rick Thorpe, MLA	**Chair**	*Okanagan Penticton*
Evelyn Gillespie, MLA	**Deputy Chair**	*Comox Valley*
Pietro Calendino, MLA		*Burnaby North*
Jim Doyle, MLA *(to April 3, 2000)*		*Columbia River-Revelstoke*
Helmut Giesbrecht, MLA *(to April 3, 2000)*		*Skeena*
Rick Kasper, MLA		*Malahat-Juan de* Fuca
Steve Orcherton, MLA		*Victoria-Hillside*
Dennis Streifel, MLA		*Mission-Kent*
Erda Walsh, MLA		*Kootenay*
David Zirnhelt, MLA		*Cariboo South*
Murray Coell, MLA		*Saanich North and the Islands*
Gary Farrell-Collins, MLA		*Vancouver-Little Mountain*
John Weisbeck, MLA		*Okanagan East*
Jack Weisgerber, MLA		*Peace River South*

Clerk to the Committee

Craig James
Clerk of Committees and Clerk Assistant

Researcher to the Committee

Kelly Dunsdon
Committee Researcher

Terms of Reference

On April 3, 2000, the Hon. Dale Lovick moved that the following reports of the Auditor General of British Columbia be re-referred to the Select Standing Committee on Public Accounts:

- Report on the 1997/98 Public Accounts - Part I (November 1998)
- Report 4: A Review of the Estimates Process in British Columbia (February 1999)
- Report 5: Protecting Drinking-Water Sources (April 1999)
- 1998/99 Annual Report: Auditing in the Public Interest (June 1999)
- Report 1: Follow-up of Performance Audits/Reviews (May 1999)
- Report 2: Report on Government Financial Accountability for the 1997/98 Fiscal Year Parts II and III (June 1999)
- Report 3: Maintaining Human Capital in the British Columbia Public Service - The Role of Training and Development (August 1999)
- Report 4: Managing the Woodlot Licence Program (August 1999)
- Report 5: A Review of the Fast Ferry Project: (October 1999)
- Report 6: Forest Renewal BC - Planning and Accountability in the Corporation; The Silviculture Programs (October 1999)
- Report 8: Social Housing - The Governance of the British Columbia Housing Management Commission And the Provincial Rental Housing Corporation; The Management of Social Housing Subsidies (November 1999)
- Report 9: Pulp and Paper Mill Effluent Permit Monitoring; Standards of Conduct in the Education And Health Sectors; Status of Public Accounts Committee Recommendations Relating to Prior Years' Compliance Audits (November 1999)
- Report 10: Report on Government Financial Accountability For the 1998/99 Fiscal Year (Parts I and II) (February 2000)

and that the following report of the Auditor General of British Columbia be referred to the Select Standing Committee on Public Accounts for the first time:

- Report 11: Towards a More Accountable Government: Putting Ideas Into Practice (March 2000)

In addition to the powers previously conferred upon the Select Standing Committee on Public Accounts, the Committee be empowered:

(a) to appoint of their number, one or more subcommittees and to refer to such subcommittees any of the matters referred to the Committee;

(b) to sit during a period in which the House is adjourned, during the recess after prorogation until the next following Session and during any sitting of the House;

(c) to adjourn from place to place as may be convenient; and

(d) to retain personnel as required to assist the Committee,

and shall report to the House as soon as possible, or following any adjournment, or at the next following Session, as the case may be; to deposit the original of its reports with the Clerk of the Legislative Assembly during a period of adjournment and upon resumption of the sittings of the House, the Chair shall present all reports to the Legislative Assembly.

PART 1
REPORT ON THE 1997/98 PUBLIC ACCOUNTS

INTRODUCTION

The *Financial Administration Act*, R.S.B.C. 1996, c. 138 provides that the government's financial statements must be finalized no later than the end of September each year, six months after the fiscal year end. The Act also requires the government to prepare Public Accounts, containing the financial statements and other information, by no later than December 31st following each fiscal year end.

On October 20, 1998, the 1997/98 Public Accounts for the Province were issued, and in November of 1998, the Auditor General issued his report entitled "Report on Government Financial Accountability for the 1997/98 Fiscal Year: Part I - Report on the 1997/98 Public Accounts".

Unlike in previous years, the Auditor General's report on the Public Accounts for the fiscal year 1997/98 formed Part I of a larger report which addressed government financial accountability for the fiscal year 1997/98. Part I of the Auditor General's report provided information respecting his audit of the Summary Financial Statements of government entities, trust funds and other organizations, as well as the Consolidated Revenue Fund Financial Statements, for the fiscal year ended March 31, 1998. The remainder of the report, relating to the province's financial management, and financial systems and controls, was issued in June 1999 and is discussed below in this report commencing at page 17.

Representatives of the Auditor General's office attended before your committee, and provided members with an overview of the Public Accounts for 1997/98. As well, the Comptroller General provided the committee with information regarding the government's response to the Auditor General's comments and recommendations.

In particular, your committee discussed:

- Changes to and improvements in the Public Accounts for the fiscal year 1997/98;
- The audit of the Province's financial statements for the fiscal year ending March 31, 1998 (Summary Financial Statements and Consolidated Revenue Fund Financial Statements), including the Reporting Entity;
- Government accounting policies; and
- Accounting and financial reporting issues for government entities.

Changes to and Improvements in the Public Accounts

The Comptroller General advised your committee that there were a number of changes and improvements reflected in the Public Accounts for the fiscal year 1997/98.

Firstly, he noted that an aggressive timetable was established for the release of the Public Accounts. For the fiscal year 1997/98 the accounts were released on October 20, 1998, which was the earliest date of release in some time.

Your committee also discussed the fact that more Public Accounts information is now available on the Ministry of Finance and Corporate Relations' website (URL www.fin.gov.bc.ca), allowing easier access for the public.

Other changes to and improvements in the Public Accounts for 1997/98 were drawn to your committee's attention, as follows:

- There was a move toward capitalization of tangible capital assets and full accrual accounting;
- More information was disclosed in the notes to the Public Accounts;
- Most colleges and institutes moved toward the use of not-for-profit accounting standards as in section 4400 of the Canadian Institute of Chartered Accountants handbook;
- There was a change in the way that capital is presented in the Estimates, involving increased disclosure of moneys used for capital purposes;
- The Comptroller General's office has committed to trying to release the public accounts and the debt report as close to one another as possible.

Audit of the Province's Financial Statements for the Fiscal Year ending March 31, 1998

Summary Financial Statements

The Summary Financial Statements include most entities owned or controlled by the Province, and consolidate the financial position and results of operation of the Province's general and special funds (the "Consolidated Revenue Fund") with the financial position and operating results of the government entities. These entities include:

- ***Government organizations***: corporations, associations, boards, foundations, societies, subsidized corporations that provide goods and

services to the public, and others which are separated from the operation of central government due to administrative factors;

- ***Government enterprises***: separate legal entities that earn, or are expected to earn, sufficient revenue from goods or services provided to the public to pay for their operations

The Reporting Entity

The Auditor General informed your committee that his audit of the Summary Financial Statements for the fiscal year ended March 31, 1998 revealed that, while the statements generally present fairly the financial position, results of operations and changes in financial position of the Province, there was one reservation. In this regard, the Auditor General noted that regional hospital districts, public health care organizations, universities, colleges, institutes and school districts (commonly referred to as the "SUCH" sector) should be part of the reporting entity and included in the Summary Financial Statements. It was emphasized to your committee that the test for determining whether or not an organization should be included in the reporting entity, as determined by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants, is composed of 2 steps:

- Whether the organization is accountable for the administration of its financial affairs and resources to a minister of the government or to the Legislative Assembly; and
- Whether the organization is owned or controlled by the government.

While the Auditor General and Comptroller General generally are in agreement that these criteria are appropriate tests to determine the reporting entity, there is some disagreement about whether the SUCH sector meets the criteria. The Auditor General submitted to committee members that, according to this test, the "SUCH" sector should be part of the reporting entity. However, committee members also heard that the government has decided to exclude the "SUCH" sector from the summary financial statements on the basis that, when an entity is part of a province-wide program, is locally-based and has initial accountability to a local board, it should be excluded.

In response to this, the Auditor General advised that excluding the SUCH sector from the Summary Financial Statements affects the reporting of government operations. In particular, your committee notes that the Auditor General's report identified the impacts on the 1997/98 Public Accounts as follows:

- Decrease in tangible capital assets by approximately $8.0 billion;

- Increase in loans receivable by $5.0 billion;
- Decrease in "other assets" and "other liabilities" by $1.3 billion each;
- Increase in the net deficiency (accumulated deficit) of the Province by $2.9 billion (from $7.3 billion to $10.2 billion);
- Decrease in "revenue" by approximately $1.4 billion;
- Decrease in "expense" by approximately $1.2 billion;
- Increase in net operating expense by approximately $0.2 billion.

However, the Comptroller General advised your committee that the reporting entity in British Columbia is comparable with that in other jurisdictions, and that his office is continuing to monitor developments elsewhere in this regard. As well, it was pointed out that moving to a larger reporting entity would have actually improved by $150 million, rather than negatively impacted, the government's financial results as reflected in the Summary Financial Statements for 1997/98.

Your committee notes that the Budget Process Review Panel report ("Enns Report") issued in September 1999 recommends that the SUCH sector be included in the reporting entity to the extent required by Generally Accepted Accounting Principles, such that both budgets and public accounts use the expanded summary entity. The panel was of the view that this recommendation should be phased in over a period of several years.

Consolidated Revenue Fund Financial Statements

The Consolidated Revenue Fund is the fund into which all public money of the government, other than trust funds, must be paid. Your committee discussed the purpose of the Consolidated Revenue Fund Financial Statements, which is to compare actual results of fund operation with the intended results as approved by the Legislative Assembly in the Estimates process.

Committee members heard that the Auditor General's report on the 1997/98 Public Accounts contained a reservation with respect to the way the government has treated $5.8 billion in loans recoverable through future appropriations. In particular, the Auditor General noted that the government recorded such loan amounts as assets of the Consolidated Revenue Fund. However, the Auditor General noted that these loans do not have the necessary characteristics of assets and should have been accounted for as an expenditure of the Consolidated Revenue Fund for the period in which each loan was incurred.

As well, representatives of the Auditor General's office expressed a reservation about the government's accounting treatment of $555 million for certain debts of government organizations that were guaranteed by the Province but were expected to be repaid by future government funding. Committee members heard that the government should be recording these debts as a direct liability of the Consolidated Revenue Fund, to reflect the fact that by providing funding for the purpose of repaying such debts, the government has in effect taken over responsibility for such debts.

The Auditor General's report stated that the government's treatment of those loans and debts had the following impact on the 1997/98 Public Accounts:

- Decrease in the net deficiency as at March 31, 1998 by $6,309 million;
- Decrease in liabilities as at March 31, 1998 by $555 million;
- Decrease in net operating expenses for the year ended March 31, 1998 by $111 million.

However, it was drawn to the committee's attention that the issue of accounting for loans made by government to dependent organizations is currently being addressed. For example, in April 1998 and July 1998 respectively, the *Capital Financing Authority Repeal and Debt Restructuring Act*, S.B.C. 1998, c. 6, and the *Greater Vancouver Transportation Authority Act*, S.B.C. 1998, c. 30, came into effect. These pieces of legislation eliminated three capital financing authorities through which loans for the purchase of assets, recoverable from future appropriations, were made. This legislation also provided that the debt held by government organizations will be forgiven, and the amounts paid out by the government for the purchase of tangible capital assets will be recorded as prepaid capital advances, which will then be reflected on the Consolidated Revenue Fund Financial Statements.

Furthermore, steps have been taken to ensure that guaranteed loans of entities dependent on government funding will be accounted for as a liability of government

Financial Highlights of the 1997/98 Public Accounts

Your committee received a brief overview of the financial highlights of the 1997/98 Public Accounts from a representative of the Auditor General's office. In particular, your committee discussed the following:

- ***Revenue:*** members heard that in 1998 taxation accounted for 55 cents of every dollar of provincial revenue, and therefore remained the most important source of revenue for the government. Your committee was also advised that, from 1994 to 1998 inclusive, gross natural resource revenue grew significantly while contributions from the federal government declined.

- ***Expenses:*** Representatives of the Auditor General's office noted that for accounting purposes government expenses are divided into groups referred to as "functions". These "functions" are health, education, social services, transportation, protection, economic development and general government. Committee members were informed that, from 1994 to 1998 inclusive, health, education and social services combined to account for an average of 68% of the total expenses for the province.

- ***Key Financial Indicators***

  a) ***Deficit:*** your committee was advised by representatives of the Auditor General's office that over the period 1994 to 1998, the accumulated deficit (the sum total of all government deficits and surpluses to date) increased 15%, from $6.4 to $7.3 billion.

  b) ***Net Public Debt:*** according to the Auditor General's report, net public debt in British Columbia (defined as the total of the provincial debt, including certain guaranteed debt, less any sinking fund assets set aside for its repayment) increased by 16.4% from 1994 to 1998, from $26.1 to $30.3 billion. These figures were based on the expanded reporting entity, which includes the "SUCH" sector. However, the government does not report on an expanded entity basis (although additional unaudited information outlining the impact of the expanded reporting entity has been contained in Volume 1 of the Public Accounts). Therefore, your committee has learned that the Public Accounts, Debt Statistics Report, and Financial and Economic Review for the fiscal year 1997/98 stated the increase in debt to be from $25.9 billion to $30.2 billion for the same period of time.

  c) ***Net Liabilities:*** net liabilities represent the difference between total liabilities and financial assets, and are an indicator of the province's financial indebtedness. Committee members were made aware that

the net liabilities of the Province increased 23.3% from 1994 to 1998, from $16.0 to $19.8 billion.

d) ***Annual Surplus (Deficit) Compared With % Change in Gross Domestic Product:*** representatives of the Auditor General's office stated that from 1994 to 1998 inclusive, there was a 17% growth in the economy, as indicated by the percentage change in Gross Domestic Product. During the same period, the annual result of operations of the government improved from a deficit of $864 million in 1994 to a deficit of $282 million in 1998.

Government Accounting Policies

The Auditor General's report also addressed the government's accounting policies and offered several recommendations.

Expense basis of accounting:
Committee members heard that prior to 1995/96, the Province's financial statements were presented on the expenditure basis of accounting, whereby the full cost of tangible capital assets is charged to operations only when those assets are acquired. However, in 1995/96 the government started employing the expense basis of accounting. As such, the full cost of capital assets acquired are now presented as assets on the balance sheet, and that cost is amortized as an operating expense over the asset's useful life.

Tangible capital assets:
Your committee was advised by representatives of the Auditor General's office that in 1997/98 the Minister of Finance and Corporate Relations committed to a proposed capitalization schedule whereby all tangible capital assets will be capitalized by the year 2002. As well, the

The Office of the Auditor General of British Columbia recommends that:

- We recommend that the government expedite recording in its financial statements the cost of land used for provincial buildings.
- We recommend that, on a timely basis, the government develop a central database of relevant information on all land owned by the Province.
- the government provide ministries with clear and detailed guidance on accounting for the capitalization of land.
- the government provide ministries with adequate training to enable them to consistently apply guidelines on accounting for tangible capital assets.
- in keeping with the substance of the agreement with PHH Vehicle Management Services Inc., the sales transaction be accounted for as a capital lease, and be recorded as an asset and a liability in the Province's financial statements.

committee was assured that the Comptroller General has been working in conjunction with the Auditor General to develop a consistent capitalization policy. Guidelines on the capitalization of tangible capital assets have been issued, and training courses have been held with ministries to address budgeting for capital and recording capital.

Representatives of the Auditor General's office pointed out that capitalization of some tangible capital assets has proven challenging, and as such the Auditor General has made recommendations as noted above. In particular, your committee discussed the fact that complete and accurate land information is often not readily available to enable government to identify and value land acquired and owned by the province. However, committee members were pleased to hear that the government has committed to developing a dedicated land database to be used by ministries in the valuation of land when it is capitalized.

Determining the Cost of Parkland

The Auditor General's report stated that park acquisition costs have been determined inconsistently because there is no clear guidance on which costs are to be capitalized. This is particularly so in cases where existing users of land are compensated with conditions for their relocation. As such, the Auditor General made a specific recommendation to the government to develop guidelines in this regard.

The Office of the Auditor General of British Columbia recommends that:

- the Province develop guidelines to help government negotiators and the Comptroller General determine which costs incurred when creating a park should be capitalized and which should be charged to normal operations.

The Comptroller General informed your committee that he is in agreement with the Auditor General's call for guidelines in this area, and that progress is being made.

Gross basis of accounting

Your committee heard that a fundamental principle of financial statement presentation is the use of the gross basis of accounting, but that there has been a growing trend in the Consolidated Revenue Fund financial statements to net certain expenses against the related revenues. This has been the case with the treatment of government assistance to Canadian Airlines International,

The Office of the Auditor General of British Columbia recommends that:

- the government use the gross basis of accounting for the Consolidated Revenue Fund Financial Statements.

provision for bad debts, costs incurred by the Liquor Licensing Branch, and management fees revenue. As noted above, the Auditor General has recommended that the gross basis of accounting be used for these financial statements.

In response to this concern, the Comptroller General advised that the gross basis of accounting may in some instances be an impediment to good management. For example, he told committee members that allowing ministries to net expenses incurred in using the debt collection services of the Ministry of Finance and Corporate Relations' Loan Administration Branch (the "LAB") against revenues provides an incentive for ministries to use the LAB's services. However, the Comptroller General did agree that increased disclosure must accompany this practice, to ensure that a full picture of the government's operations may be presented to the public.

Accounting and Reporting Issues for Government Entities

Liability for Post-Retirement Benefits

Representatives of the Auditor General's office further informed your committee that, although the Canadian Institute of Chartered Accountants has recommended accounting for post-retirement benefits provided to retired government employees (such as payment of Medical Services Plan premiums and extended health premiums), the government has taken the position that estimating this liability would be too expensive.

The Office of the Auditor General of British Columbia recommends that:

- a reasonable estimate of post-retirement benefits be included as a liability in the Summary Financial Statements of the Province.

Committee members heard that, while the Comptroller General agrees in principle with the Auditor General's recommendation in this regard, government has been waiting for the Public Sector Accounting Board ("PSAB") of the Canadian Institute of Chartered Accounts ("CICA") to provide some guidance on the matter. In this regard, your committee notes that a policy concerning accounting for post-retirement benefits was issued by CICA in March 1999, but that policy is aimed at the private sector, and there has been no direction provided from the PSAB to date. CICA guidance for private sector firms is to be effective by the fiscal year 2000, although earlier adoption is being encouraged.

Insurance Risk Management Account (IRMA)

The Office of the Auditor General of British Columbia recommends that:

- the Province account for all its liability for third-party insurance claims.

Your committee discussed the fact that, currently, the government records a liability when a claim is made and accepted by the risk management office. However, the Auditor General is of the view that liability should be recorded for incidents that have occurred as of March 31st of a given year, but for which no claim has been filed or accepted as of that date.

The Comptroller General submitted that these liabilities are difficult to measure, in that the extent of these claims are not necessarily known or easily ascertained.

Contributions to Government Organizations

The Office of the Auditor General of British Columbia recommends that

- the government account for payments to its organizations in a manner that reflects the substance of the transactions.

Your committee notes that the Auditor General's report identified some concerns with respect to the way government accounted for payments to government organizations during the fiscal year 1997/98. In particular, the report noted that the government had not applied a consistent approach to accounting for similar types of contributions. For example, a $45 million contribution was made to the Columbia Basin Trust on April 1, 1996 and the payment was recorded as an investment, rather than being expensed as a grant. The Auditor General was of the view that contributions should not be recorded as investments when the government is funding its non-commercial businesses, because there is no expectation of any return to the Consolidated Revenue Fund.

However, the Comptroller General submitted to your committee that payments such as that to the Columbia Basin Trust should indeed be viewed as an investment, because assets are acquired, and benefits flow as a result of those assets. He also noted that as those assets depreciate, they are written off to reflect diminishment in the investment.

Accounting Issues Related to the Reorganization of the Health Care Sector

In his report, the Auditor General called for a larger reporting entity, including the "SUCH sector". However, it was drawn to your committee's attention that there were some concerns on the part of religious groups operating health care organizations, regarding the inclusion of privately-owned assets in the financial information made public by the government. As such, the Auditor General suggested that if the health care sector is included in the reporting entity, government should include a notation in the Province's financial statements to properly reflect ownership of these assets.

The Office of the Auditor General of British Columbia recommends that:

- the government include an appropriate note in the Province's financial statements and financial information it provides on health care to reflect the ownership of certain privately owned assets employed in providing health care services to British Columbians.

The Comptroller General told committee members that he is in agreement with the Auditor General's recommendation to include a note in the financial statements to properly reflect ownership of privately-owned assets. Your committee notes that this information was included in the Public Accounts for 1998/99.

The Need for Better Accounting Standards in School Districts

In his report, the Auditor General identified financial reporting in the education sector as an area of concern. In particular, he noted that school district financial statements are not being prepared in a unified and consistent manner, making financial comparison between school districts difficult. As well, the audit revealed that school districts are not comparing current year balances with previous years, which would provide valuable information.

Office of the Auditor General of British Columbia recommends that:

- We recommend that the government conduct a comprehensive review of accounting for school districts, with the purpose of improving their financial accountability.

Committee members heard that the Comptroller General's office has commenced a review of the accounting policies for school districts, and will be working with the Ministry of Education to provide guidance and ensure consistency with the Canadian Institute of Chartered Accountants' standards.

COMMITTEE RECOMMENDATIONS

1. Your committee endorses the Auditor General's recommendations relating to the 1997/98 Public Accounts, contained in his *Report on Government Financial Accountability for the 1997/98 Fiscal Year, Part I, Report on the Public Accounts,* and recommends that the government
   - Expedite recording in its financial statements the cost of land used for provincial buildings;
   - On a timely basis, develop a central database of relevant information on all land owned by the Province;
   - Provide ministries with clear and detailed guidance on accounting for the capitalization of land;
   - Provide ministries with adequate training to enable them to consistently apply guidelines on accounting for tangible capital assets;
   - In keeping with the substance of the agreement with PHH Vehicle Management Services Inc., account for the sales transaction as a capital lease, and record it as an asset and a liability in the Province's financial statements;
   - Develop guidelines to help government negotiators and the Comptroller General determine which costs incurred when creating a park should be capitalized and which should be charged to normal operations;
   - Include a reasonable estimate of post-retirement benefits as a liability in the Summary Financial Statements of the Province;
   - Account for all its liability for third-party insurance claims;
   - Account for payments to its organizations in a manner that reflects the substance of the transactions;
   - Include an appropriate note in the Province's financial statements and financial information it provides on health care to reflect the ownership of certain privately owned assets employed in providing health care services to British Columbians;
   - conduct a comprehensive review of accounting for school districts, with the purpose of improving their financial accountability.

PART 2
REPORT ON THE PROVINCE'S FINANCIAL MANAGEMENT

INTRODUCTION

Part 2 of the Auditor General's *Report on Government Financial Accountability for the 1997/98 Fiscal Year* was issued in June 1999. Part 2 of the report provided comments regarding the province's financial management, specifically the reporting of provincial debt and debt management planning. The comments were based on the latest audited information available to the Auditor General at the time the audit was conducted (information contained in Budget '98 and, where relevant, Budget '99).

While the Auditor General did not make any recommendations to the government relating to the reporting of provincial debt or debt management planning, he did note that total debt for the province of British Columbia has increased every year since the fiscal year ending March 31, 1990. In fact, he advised that between March 31, 1990 and March 31, 1998 the province's total debt rose from $16.3 billion to $30.3 billion (on the basis of the expanded reporting entity). According to Budget 1999, by the end of the fiscal year 1999/2000, the provincial debt was expected to total approximately $34.7 billion (although the revised forecast in Budget 2000 was $34.3 billion).

Part 2 of the Auditor General's report was considered by your committee in October 1999. At that time, representatives of the Auditor General's office attended before your committee, as did the Secretary to Treasury Board and representatives of Treasury Board Staff.

DEBT REPORTING AND DEBT/FINANCIAL MANAGEMENT PLANNING IN BRITISH COLUMBIA

In 1991/92, the Auditor General identified key measures and indicators necessary for accountability on debt, as follows

- Debt to revenue
- Total provincial debt
- Debt per capita
- How debt changed
- Why debt changed, including the operating deficit

- Sources of borrowing
- Interest bite
- Debt to Gross Domestic Product ("GDP")
- Total cost of debt servicing
- Rate of interest

The Debt Statistics report produced by the government each year is the mechanism by which these key measures and indicators of public debt are reported in British Columbia.

Since Budget '95, the government has also used various debt management plans to provide goals and benchmarks for debt planning in the province. The Auditor General's report described and assessed the measures and indicators used to develop these goals and benchmarks.

However, the Auditor General observed that excessive modification of the government's debt plan may defeat the purpose of having a plan, and may erode public confidence in the reliability of the planning information that government presents to the Legislative Assembly and to the public. Furthermore, he submitted that the government could improve upon the information contained in the annual Debt Statistics report by including a comparison of the current year's measures and indicators with those estimated in the previous year's budget documents.

Budget '95 Debt Management Plan

The Auditor General's report noted that the first debt management plan introduced in British Columbia in modern history was the Debt Management Plan contained in Budget '95. The plan was intended to be long-term in nature, with a planning period of 20 years, and benchmarks established at 5-year intervals. Moreover, the plan included 4 goals for debt management, as follows:

- To maintain British Columbia's credit rating as the highest of all Canadian provinces
- To eliminate, over 20 years, the $10.2 billion debt from previous budget deficits, by using budget surpluses to pay down debt
- To reduce, over 20 years, the taxpayer-supported debt to GDP ratio (to 15% by the year 2015)
- To cap the interest cost of taxpayer-supported debt (the "interest bite"), so as to ensure that it did not exceed 8.5% of provincial revenue over 20 years.

Budget '97 Financial Management Plan

The government replaced the Budget '95 Debt Management Plan in 1997, based on a determination that the goals of that plan were not achievable. To replace the plan, a Financial Management Plan was developed which focused on medium-term planning for the period 1997/98 – 1999/2000. The new plan focused on capping the taxpayer-supported debt to GDP ratio and the taxpayer-supported interest bite. Furthermore, based on business and labour panel advice, the plan included other targets relating to balancing the operating budget and reducing direct debt over 20 years.

However, the Auditor General's report noted that the Budget '97 Financial Management Plan contained certain shortcomings, as follows:

- No indication was given in the plan as to how targets relating to reduction of the taxpayer-supported debt to GDP ratio
- The plan assumed balanced budgets or better, but did not plan for any substantial repayments of existing direct debt
- The plan did not include the goal of British Columbia maintaining the highest credit rating of all Canadian provinces. In this regard, the Auditor General is of the view that a useful goal would be the maintenance of a certain credit rating, regardless of what happens in other jurisdictions. Your committee has learned that in fact British Columbia's credit rating has declined over the last two to three years, such that the province now has the second-best credit rating in Canada (AA-).

Budget '98 Financial Management Plan

The Auditor General's report explained that, due to unpredictability in the rate of economic growth, in 1998 the government changed its financial management plan again to allow for more flexibility with respect to debt-to-GDP ratio targets. The new plan included the following goals:

- To limit the taxpayer-supported debt-to-GDP ratio to a range of 19-22% over the following 3 years, with the target range to be reviewed annually and lowered as the debt-to-GDP ratio declines
- To limit the taxpayer-supported debt-to-GDP ratio at March 31, 1999 to 21.2%
- To balance the Consolidated Revenue Fund's operating budget for 1999/2000
- To maintain, per dollar of revenue, the 9% cap on the taxpayer-supported interest bite

Committee members heard that the Auditor General identified several concerns relating to the Budget '98 Financial Management Plan, including the following:

- The plan did not include a goal to eliminate or reduce the direct debt. In this regard, your committee was made aware of the Auditor General's view that the government should maintain a distinction between debt used for government operating purposes, and debt used for capital spending
- Not enough information regarding the target of 19% - 22% set for taxpayer-supported debt to GDP ratio was provided to determine if it is reasonable
- While the taxpayer-supported debt-to-GDP ratio is a useful long-term trend indicator, it is too unpredictable a measure to use in short-term planning. The Auditor General submitted that the government should instead focus on a long-term taxpayer-supported debt-to-GDP goal
- The plan was more a short-term estimate of debt than a long-term plan to harness and control the debt, as was Budget '95's Debt Management Plan
- The goal of balancing the operating budget should have been based on the Summary Financial Statements rather than the Consolidated Revenue Fund, because the summary entity best reflects all operations over which the government has control.

Budget '99 Five-Year Fiscal Planning Framework

The Auditor General's report pointed out that, unlike budgets since 1995, Budget '99 did not discuss the financial management plan, but rather contained a brief reference to a "Five-Year Fiscal Planning Framework" for managing taxpayer-supported debt (which constitutes about $27 billion of $35 billion in total debt). As such, it was not clear if the financial management plan had been abandoned, or replaced with a new plan. Moreover, the goal regarding taxpayer-supported debt-to-GDP ratio had been adjusted to between 22% and 27% over the next 5 years.

Debt Management and Crown Corporations

Committee members were also made aware that the Five-Year Fiscal Planning Framework did not purport to manage the affairs of commercial Crown corporations such as B.C. Rail, B.C. Hydro or the Insurance Corporation of B.C., which have their own financial management plans. The Budget Process Review Panel, which issued its report on the Estimates process in British Columbia in September 1999, has recommended that the focus of overall financial indicators, such as total debt, should be on the Expanded Summary Entity basis. The Expanded Summary Entity includes not only the Consolidated Revenue Fund, but also Crown corporations, other agencies, and "SUCH" sector public bodies (school districts, universities, colleges, institutes, health care organizations and regional hospital districts) that meet the Generally Accepted Accounting Principles criteria for inclusion in the entity. In this regard, your committee was advised that there is still some debate within government about whether commercial Crown corporations should be included in consolidated debt. As well, your committee notes that the debt statistics report does include ratios for taxpayer-supported as well as total provincial debt.

Concern was also expressed from within the committee about the tension between the need to represent commercial Crown corporation shareholders' interests through the payment of dividends, and the broader public interest in debt management. Treasury Board's directives regarding payment of dividends by B.C. Hydro, B.C. Buildings Corporation and B.C. Rail were cited as examples. In response to these concerns, the Secretary to Treasury Board submitted that, although there is not always consensus, there is a well-developed and inclusive process in place to examine dividend payment in commercial Crown corporations.

Finally, your committee discussed the debt increases experienced in Crown corporations in recent years, and the processes used to monitor Crown corporation debt. In particular, the increase in the debt of the B.C. Ferry Corporation was considered. The Secretary to Treasury Board indicated that in recent years there have been efforts by the corporation and Treasury Board to look at remedial measures, including rate increases, containment of internal administrative costs, measures to constrain collective agreement costs and re-alignment of routes. Some concern was also expressed from within the committee regarding the role the corporation's capital plan has played in debt growth. In this regard, the Secretary to Treasury Board noted that there must be an examination of the longer-term debt structure of the corporation, and measures to balance the corporation's debt management with its capital plan requirements. In fact, since the committee met on this

subject, the government has announced that it will take over $1.08 billion of the corporation's debt, and introduce a permanent annual subsidy of 1.25 cents per litre from the motor fuel tax.

Skeena Cellulose Inc.

The Auditor General's report also discussed the provincial government's debt related to Skeena Cellulose Inc. ("Skeena"). Skeena is a forest products company located in northern British Columbia which encountered financial difficulties beginning in the mid-1990's. In response to the threat of company closure, in 1997/98 the province (through a subsidiary called "552513 British Columbia Ltd.") acquired majority ownership interest in Skeena. As part of the transaction, Skeena's debts to its two major creditors (Royal Bank and TD Bank) were restructured.

Because 552513 British Columbia Ltd. has a majority ownership in Skeena, and 552513 British Columbia Ltd. is owned by the province, all the debts related to Skeena were included in the province's debt statistics report for 1997/98, although not included in the public accounts. According to the 1997/98 Debt Statistics report, the government's ownership of Skeena increased the total provincial debt by $157.1 million. While the Debt Statistics report referred to this as "self-supporting debt", the Auditor General's views were to the contrary due to the volatile nature of world pulp prices. As a result, the Auditor General noted his plans to continue monitoring the profitability of Skeena to determine if its debt should be re-classified as taxpayer-supported debt.

It was forecast in Budget '99 that the debt of 552513 British Columbia Ltd. would rise to $224.7 million at March 31, 1999, and to $319.3 million at March 31, 2000. However, the Comptroller General noted only a portion of this was the responsibility of the province, in that there were other shareholders as well (i.e. TD Bank, and company employees, through a trust giving them a 20% share in the company). He also advised committee members that, as of March 31, 1999, the province's liability for debt relating to Skeena was $128.5 million.

Debt Measures and Indicators for 1997/98

The Auditor General's report also contained information and comments relating to specific debt measures and indicators for 1997/98 – those measures and indicators were:

- Total provincial debt, including debt per capita and debt-to-revenue ratio
- Changes in debt – including information regarding why and from whom the province has been borrowing
- Financial well-being of the province, including interest bite and debt-to-GDP ratio
- Cost of debt servicing

Your committee notes that, in keeping with a decision made in 1996, for the fiscal year 1997/98 the provincial government excluded the SUCH sector from the reporting entity. However, due to his view that the SUCH sector should be included in the government's Summary Financial Statements, the debt measurement information in the Auditor General's report was based on a reporting entity that includes these sectors.

Total Provincial Debt

Total debt includes amounts borrowed for the operation of central government and government agencies, as well as third-party debt guaranteed by the government. Total debt also includes funds borrowed under the "warehouse borrowing program" where, to take advantage of market opportunities, funds are borrowed before they are actually required and re-invested in high-quality debt instruments until such time as the funds are actually needed.

Your committee learned that the total debt for the province of British Columbia increased from $29.3 billion in 1997, to $30.3 billion in 1998 (based on the expanded reporting entity upon which the Auditor General based his review), broken down as follows:

- Summary Financial Statements - $29.1 billion
- Government Enterprises - $0.8 billion
- Third-party guaranteed debt - $0.2 billion
- SUCH sectors - $0.2 billion

The Auditor General's report pointed out that there are two important trend indicators with respect to provincial debt. The first of these, debt per capita, shows the average amount of provincial debt owed by each British Columbian. For 1997/98, the debt per capita increased from $7,558 to $7,653.

The second indicator regarding total provincial debt is debt-to-revenue, which indicates the affordability of the debt. Committee members heard that debt-to-revenue (based on revenue which includes that generated by the SUCH sectors) rose from 94.6% in 1996/97 to 95.2% in 1997/98, meaning that the rate of increase in debt was higher than the rate of increase in revenue.

Changes in Debt

Your committee learned that the total debt of British Columbia increased by $998 million during the fiscal year 1997/98.

The Auditor General has recognized the government's efforts to provide annual information about changes in the debt, and has encouraged the province to continue to improve its reporting by including a list of the sources and uses of current borrowings, such as debt repayment, financing of annual operating deficits, lending, warehousing and capital spending.

Financial Well-Being of the Province

The Auditor General's report noted that two important indicators of the province's financial well-being are interest bite and the debt-to-GDP ratio.

The interest bite indicates how much of each dollar of revenue is used to service the debt. In 1997/98, this amount (including a consideration of the SUCH sector) was approximately 7.2 cents, a decrease in 0.5 cents from the previous year, meaning that the rate of increase in revenue was higher than the rate of increase in debt-servicing costs.

The Secretary to Treasury Board noted that, when the SUCH sector is excluded, the interest bite as of the date the committee met (October 1999) was approximately 9 cents. However, he advised your committee that this is not unreasonable when viewed in comparison with the rest of the country, and particularly with the federal government, which is facing an interest bite of approximately 27 cents. He further noted that an interest bite of 10 cents or under is considered manageable.

The debt-to-GDP ratio compares total net debt outstanding at the year-end to the annual GDP of the province. The debt-to-GDP ratio remained unchanged from 1997 to 1998, at 27.7%. In fact, the provincial debt as a percentage of GDP remained essentially flat from 1993 to 1998 although, as one member of the committee pointed out, nominal revenue during that period was actually increasing. However, the Auditor General has noted that Budget '99 predicted the ratio to increase to 29.6% by March 31, 1999, and 31.7% by March 31, 2000.

Cost of Debt Servicing

The cost of debt servicing is arrived at by adding the interest paid on debt to the incidental costs associated with the administration of debt, and deducting from that amount any investment income from sinking funds.

Your committee learned that the cost of debt servicing for 1997/98, including the SUCH sectors, was $2,302 million, down from $2,400 million in 1996/97.

Provincial Government Response to the Auditor General's Comments

The Secretary to Treasury Board attended before your committee to respond to the Auditor General's comments regarding debt management and reporting. Rather than focusing upon the fiscal year 1997/98, he discussed debt management during the period 1995/96 to 1999/2000. In particular, he submitted that the increased provincial debt over that period is reflective of increased expenditures to address capital infrastructure and other needs, and a decline in real per capita revenues.

Expenditures

Committee members were advised that, over the past couple of years, the government has doubled the amount of money it spends on annual capital expenditures from approximately $1 billion to over $2 billion. As well, spending on grant programs in the social services area (health, education, advanced education, children and families) increased over the 1995/96 to 1999/2000 period by 15%.

Revenues

The Secretary to Treasury Board informed the committee that from 1995/96 to 1999/2000, real per capita revenues in the province (per capita revenue adjusted for inflation) declined by 5.6%, although nominal revenues did grow by 3.5% over the same period. In contrast, however, your committee notes that nominal revenues for the preceding 4-year period of 1991/92 – 1996/97 increased by 35%.

Committee members heard that the decrease in real per capita revenue in British Columbia in recent years reflects federal and provincial changes which impact on the tax base. As a result of those changes, at the end of the fiscal year 1998/99 there was approximately $1 billion less in annual revenue than there was at the end of the fiscal year 1994/95, broken down as follows:

- approximately $800 million resulting from provincial revenue measures, such as reduction of the provincial personal income tax rate and the small business corporate income tax rate;
- approximately $200 million resulting from federal measures such as tax credit and deduction enhancements, and increases in the basic personal tax credit. In this regard, representatives of Treasury Board Staff emphasized the unpredictable nature of federal tax measures, noting that when the federal budget is tabled, the entire substance of it and its implications for the provinces are not known until much later.
- Furthermore, while there are meetings between provincial and federal officials during the course of the year to discuss provincial and federal finances and forecasting, no information is released regarding anticipated federal tax measures. Concern was expressed from within your committee regarding the need for a more open budgeting process in Canada.

Representatives of Treasury Board Staff further submitted to your committee that cuts in transfers to British Columbia via the Canada Health and Social Transfer since 1994/95 have affected the province's revenue base.

Expenditure Measures

The Secretary to Treasury Board outlined some of the expenditure measures used to cope with the decrease in resources available to the province over the period 1995/96 to 1999/2000. He noted that over that 4-year period, normal Consolidated Revenue Fund expenditures grew by 4.9%, with an average increase of 1.2% per year. When viewed on a real per capita basis, spending during the 4-year period in fact declined by 4.2%. Committee members heard that expenditure decreases have come from:

- Making budget cuts to 15 ministries - 13% in total (almost $300 million);
- Tightening the public sector collective bargaining framework to "zero-zero-and-2", which has resulted in public sector wage increases falling below the private sector average for the first time in 10 years;

In this regard, your committee has also received information from Treasury Board specifically regarding the costs of collective agreements with B.C. teachers and nurses from 1995 to the present. Committee members were informed that the estimated cost of general grid wage increases to teachers through the transitional collective agreement of July 1995 to June 1998 was $41.6 million, plus an annual cost of $3.3 million resulting from a provision tying the salaries of Category 3 teachers (those with 3 years' training) to the salaries of Category 4 teachers. The total additional cost of the current Provincial Collective Agreement (July 1998 to June 2001) is estimated to be

about $200 million. Total cost increases relating to the British Columbia Health Employers' Association/Nurses Bargaining Association collective agreements for the period 1995 – 2000 are estimated at $69.5 million. In this regard, it was emphasized to your committee that the current provincial collective agreement includes nurses who historically were part of the acute care and continuing sectors, and nurses from the community sector, who were incorporated into the collective agreement due to sectoral restructuring. This transfer led to costs associated with bringing the wage and benefit rates of these employees up to those set out in the provincial collective agreement, effective April 1, 1999. However, the cost increase estimates for the period prior to 1998/99 are only for those nurses employed in the acute and continuing sectors;

- Negotiating a 5-year agreement with the B.C. Medical Association, which includes a hard cap;
- Allocating grants to the Kindergarten – Grade 12 sector based upon a population formula;
- Implementing reference-based pricing in the Pharmacare program, which has saved between $40 million and $50 million annually;
- Tying post-secondary education grants to provincial priorities;
- Reducing caseloads and benefits in the B.C. Benefits program by approximately 15%.

Assets

Your committee also discussed the province's asset base in the context of provincial debt. Committee members were advised that currently, while the Debt Statistics report does include figures that attempt to take into account at least part of the province's asset base, the public accounts do not reflect the province's assets as related to its debts. The Auditor General has been urging the province to consider this issue for some time.

In this regard, your committee discussed an initiative currently underway within the government toward the capitalization of tangible assets by the year 2002, such that those assets are recognized in the province's financial statements. The government is in the final phase of this initiative, with highway assets being brought into the 1999/2000 budget. The asset classes which remain to be considered are forestry roads, silviculture and land improvements. However, the Comptroller General advised your committee that, despite this initiative, there will still be considerable assets that do not appear on the balance sheet, such as Crown lands, which are now only included to the extent that the government has had to pay or exchange assets for them.

Your committee makes no recommendations regarding debt management and reporting in British Columbia at this time.

Part 3
Report on the Province's Financial Systems and Controls

Introduction

Part 3 of the Auditor General's *Report on Government Financial Accountability for the 1997/98 Fiscal Year* provided an update on the provincial government's Corporate Accounting System ("CAS") and Corporate Human Resource Information and Payroll System ("CHIPS"), as well as discussing the Year 2000 readiness of government financial and other information systems.

Your committee met in October 1999 to discuss the CAS, and in doing so received presentations from representatives of the Office of the Auditor General, the Comptroller General for the province, and representatives of the Ministry of Finance and Corporate Relations' Corporate Accounting System Initiative. Committee members did not consider CHIPS or the Year 2000 readiness of the government's financial systems at that time. However, the committee's consideration of Year 2000 readiness in government financial systems, including CHIPS, was part of a broader consideration of Year 2000 preparedness throughout the public sector which took place in March, July and November of 1999. The committee's report regarding Year 2000-readiness in the provincial government was tabled in March 2000 as the Ninth Report of the Third Session, Thirty-Sixth Parliament.

CAS Background

The CAS is the province's government-wide corporate accounting system, implementation of which began in 1989 to replace the 20-year old Central Batching System. This initiative has been led by the Office of the Comptroller General, which has established a CAS office.

At the start of the project, the general ledger and accounts payable functions of CAS were implemented in a small number of "pilot" ministries. From 1993 to 1996, there was a loss of momentum for the project, following some setbacks experienced in 1993 when trying to develop an interface to connect all other ministries to the CAS. However, in 1996 an Executive Steering Committee was formed to review the project, and momentum in the project has been regained.

In 1996, the CAS project was broken down into two phases. Phase I, completed in April 1998, involved linking all ministries not on-line with CAS ("non-CAS ministries") to the CAS general ledger and accounts payable modules. However, your committee learned that because the CAS general ledger and accounts payable modules use Walker software, while most non-CAS ministries do not, it has been necessary to develop a new "CAS Generic Interface" ("CGI"). The CGI encrypts data for security while it is in transit between ministries and the CAS payment production facility and/or CAS general ledger, decrypts it, and converts it to a format accepted by the CAS' Walker software.

Phase II of the CAS project was initiated October 1997, with the aim of bringing more ministries on-line to CAS, creating a foundation for a truly government-wide financial accounting system, and implementing a corporate asset management application using Oracle Financials software. This affects the timeliness of reporting financial information as well – the Comptroller General has drawn to your committee's attention the fact that a separate budget module has been developed within CAS, and there is an initiative underway to create a single set of books. This will allow the Comptroller General to do more corporate reporting without having to rely on ministry systems and sub-systems. Moreover, moving to one financial management system will expedite the production of quarterly and year-end financial statements for ministries and others in the government reporting entity, as recommended by the Budget Process Review Panel in its September 1999 report (the "Enns Report").

The Auditor General's Review

The Auditor General has been monitoring the development of the CAS on an annual basis for the last five years. This particular review focused on:

- a review of controls over the CAS General Interface, to determine whether only authorized transactions are being accepted, all transactions submitted are accounted for, and transactions are processed accurately;
- whether the objectives set for Phase II of the CAS project were being met

The CAS General Interface

The Auditor General's review focused on application and environmental controls in place for CGI. Application controls are those "built-in" to the system, while environmental controls involve the computing environment in which the CGI operates.

1. Application Controls

The audit examined application controls in place to ensure:

- that all transactions were authorized;
- that all transactions are processed accurately (i.e. data converted to a readable format and accepted by Walker for posting);
- that all valid and invalid transactions are reported.

Authorization of Transactions

Your committee was pleased to hear that the review revealed that the CGI's encryption and transmission procedures prevent unauthorized transactions from being submitted. Only encrypted data is accepted by CGI for transmission and, once encrypted, data cannot be intercepted or manipulated by unauthorized parties. Moreover, a unique encryption key is provided to each ministry, which identifies the sender and ensures that only ministries can submit transactions. Finally, reports are generated by CAS and can be reviewed by ministries to detect any unauthorized transactions that have evaded other control mechanisms.

The Office of the Auditor General of British Columbia recommends that:

- The CAS office should formally sign an agreement with each ministry clearly outlining the responsibilities of each party for establishing and maintaining effective controls over data and processing. These should include the responsibilities for access to encryption keys and for reviewing reports of the transactions submitted.

However, the Auditor General has pointed out that the effectiveness of these controls is largely dependent upon proper controls being in place within ministries, and as such has recommended that agreements between the CAS and ministries clearly outline responsibilities in these areas.

On a related note, your committee was advised that there are no information and privacy concerns relating to the CAS, due to the safeguards built into the system to control and monitor access to data.

Accuracy of Transactions

Representatives of the Auditor General's office advised your committee that there are several procedures in place within the CAS to ensure that data is accurately processed and transactions are valid. Those procedures are as follows:

The Office of the Auditor General of British Columbia recommends that:

- The proposed agreement with each ministry should include the division of responsibility between the ministry and CAS for ensuring the integrity and validity of the databases used by the CGI in its edit checks.

- Comparisons are done of the totals of dollar amounts and other fields generated ***prior*** to encryption and transmission, and those generated ***after*** transmission and decryption – if a difference is noted, ministries are contacted and asked to re-submit the file;
- All transmitted data files are assigned sequential numbers, which are tracked to ensure that duplicate files are not accepted and missing files are identified. If files are received out of sequence they are not processed and the ministry is contacted;
- Two levels of edits are done – a pre-edit is conducted on each batch of transactions to ensure that the batch can be processed by CGI. A main edit is then done, involving a comparison of information contained in each transaction to that in master data banks. Staff from the Office of the Auditor General reviewed a sample of edit checks and found that they were performed as expected;
- Reports are generated by CAS for review by ministries, and act as an after-the-fact mechanism for detecting inaccurate transactions.

However, as with authorization controls, the Auditor General found that there is no clear delineation of responsibility between the CAS office and ministries for controlling the accuracy of transactions. He has therefore recommended that this be addressed by an agreement between the CAS office and ministries.

Completeness of Transactions

The Auditor General found that the same procedures used to ensure accurate transactions in the CAS also provide assurance that all transactions submitted are either received, or identified as missing. For example, transactions that are transferred but subsequently fail

The Office of the Auditor General of British Columbia recommends that:

- The proposed agreement with each ministry should include the division of responsibility between the ministry and CAS for reviewing all rejected batches and transactions reported, and resubmitting them, if appropriate.

edits must be accounted for, and all failed batches and transactions must be reported to the ministries that submitted them for further investigation and correction if necessary.

The Auditor General did emphasize, however, that the CAS does not track rejected transactions, and therefore ministry review is the sole assurance that transactions are corrected and processed, or cancelled. As such, he has recommended that the CAS office and ministries clarify the division of responsibility for reviewing rejected batches and transactions.

CAS Office Actions on Application Controls

In response to concerns identified by the Auditor General with respect to application controls, CAS office representatives advised committee members that:

- As of April 1, 1999, CAS security are issuing encryption keys directly to senior financial officers (or their designates) within each ministry. The keys are changed on an annual basis;
- Transaction reports are now reviewed on a regular basis by ministries;
- A working model has been in place for over a year and a half, to ensure that error handling and re-submission of rejected transactions are taking place in a timely manner. Under this model, error notification is taking place electronically, rather than manually as was the case previously;
- The CAS office is updating existing service-level agreements with each ministry, to be finalized by the end of March 2000. The updates will address the Auditor General's recommendations by formalizing the mechanisms for controlling authority over, and accuracy and completeness of, data and processing.

2. Environmental Controls

Aside from the 3 application controls discussed above, in the course of his review the Auditor General also examined the following environmental controls pertaining to the CGI:

- Organization and relationships
- Control over changes
- Physical Security
- Disaster Recovery

The Auditor General focused his review of CAS environmental controls on controls in the CAS office itself, rather than controls in other government systems.

Organization and Relationships

Committee members heard that the CAS office is a division of the Office of the Comptroller General, and shares responsibility with ministries for controlling expenditure transactions, as well as providing services to ministries to assist them in meeting their responsibilities under the *Financial Administration Act*. While a CGI user group, representing both CAS and the ministries, has been established, the Auditor General has noted that at the time of his review questions were still being raised at meetings of that group regarding division of responsibility and service levels. In this regard, representatives of the Auditor General's office emphasized to your committee the importance of formal agreements between ministries and CAS to define the requirements and responsibilities of each.

The Office of the Auditor General of British Columbia recommends that:

- The proposed agreement between the CAS office and each ministry, in addition to clearly outlining the responsibilities of each party for establishing and maintaining effective controls over data and processing, should define the level of service to be provided by the CAS office to the ministries.

Control over Changes to CGI

The Auditor General's review revealed that there was no formal approval process for changes to CGI, despite the importance of ensuring adequate authorization of changes. Rather, the Auditor General found that changes are merely discussed and agreed to at CGI user group meetings or via e-mail, and then documented in meeting minutes. Therefore, he has recommended implementation of a formal agreement and documentation procedure pertaining to CGI changes.

The Office of the Auditor General of British Columbia recommends that:

- Changes to the CGI should be authorized and documented, and then accepted by the users, in writing, before the changes are implemented.

However, the Auditor General did find that duties relating to CGI changes are adequately segregated. In particular, his report notes that all changes are programmed by an application programmer, then tested by a separate testing unit with user involvement when appropriate. Following testing, a quality control review is done, and the change is implemented by operations staff.

Physical Security

Committee members were pleased to hear that the Auditor General has no concerns with respect to the physical security of the CGI business operations (located in the CAS office), or the system hardware and processing (located in the office of the Information Technology Services Division of the Ministry of Advanced Education, Training and Technology).

Disaster Recovery

Representatives of the Office of the Auditor General made your committee aware that, although CAS is included in the Office of the Comptroller General's business continuation plan, CGI is not specifically referred to in that plan. It was also noted that, at the time of the review, the most recent test of the plan was in November 1997, and that test revealed the potential for some delay in resumption of operations following an interruption.

The Office of the Auditor General of British Columbia recommends that:

- The CAS office should develop and maintain a disaster recovery plan consistent with the Office of the Comptroller General's Business Continuation Plan. Staff should be trained in the procedures to follow in case of a disaster or other business interruption. As well, CAS should test its plan and, with the Ministry of Finance and Corporate Relations, insist on, and participate in regular testing of the Information Technology Services Division disaster recovery plan.

CAS Office Actions on Environmental Controls

In response to the Auditor General's recommendations pertaining to environmental controls, representatives of the CAS office submitted that the following actions have been taken:

- ***Agreements:*** the updated service-level agreements will clarify parties' responsibilities and level of service to be provided by the CAS office to the ministries;
- ***Changes to CGI:*** in addition to review of proposed changes to the CGI by the user group, the Change Management Committee is now back to active status (the committee was not active during the Auditor General's review). The committee meets monthly, and formally approves all changes to the CGI;
- ***Disaster Recovery:*** a disaster plans for CGI and Walker is now a component of the CAS business continuation plan, and was tested in August 1999. The disaster recovery plan for Oracle Financials was tested in November of 1999. In addition, the business continuation plan for CAS has undergone two reviews, and priority lists relating to critical payments done on-line and through CGI have been developed.

Status of Phase II

The Auditor General's review of CAS also included an update on the status of Phase II of the project.

Phase II, also known as the "Orca Project", was initiated in the fall of 1997 and deals with critical business requirements, including the development of additional functions and bringing additional ministries on-line to CAS. In particular, the project charter defines the objectives of Phase II as follows:

- Implementation of CAS in the Ministries of Forests and Transportation and Highways by April 1, 1999. This objective has been met;
- Creation of a foundation for a truly government-wide financial accounting system. Representatives of the Auditor General's office advised that, to meet this objective, Phase II must be able to:
  - conform to government information technology standards and strategies, while still meeting the needs of ministries using the CAS/Walker or CGI;
  - accommodate changes and re-organization of programs between ministries;
  - accommodate future electronic data interchange and other electronic commerce.
- Implementation of a corporate asset management system. In this regard, your committee learned that this objective has been partially met, in that the corporate asset management system was implemented in the Ministry of Small Business, Tourism and Culture early in 1999, and was to be tested in the Ministry of Environment, Lands and Parks late in the fall of 1999.

As of the time the Auditor General's review was conducted, 9 ministries and 8 other agencies were on-line users of CAS. These ministries and agencies no longer have their own financial systems which must interface with CAS through the CGI. Rather, they now record their transactions directly onto CAS.

Government-Wide Implementation of Oracle Financials

Your committee was advised that, because Walker did not submit a tender for Phase II of the project, Oracle Financials software was chosen in January 1998 for the project accounting, asset management and purchase order modules being developed during this phase. Moreover, committee members heard that Oracle Financials software gives government the capability of tying in financial information with performance measurement, although the

Comptroller General emphasized to committee members that options are still being considered in this regard by the Deputy Ministers' Council, with whom responsibility for this initiative lies.

There are now intentions to convert all general ledger and accounts payable modules of CAS from Walker to the Oracle software as well, after the Year 2000 challenges have been addressed.

CAS office representatives brought your committee up to date on the current status of Oracle Financials implementation. As of November 1999 there were seven organizations using Oracle Financials software. The Ministries of Environment, Lands and Parks, Education, Advanced Education, Labour, and Children and Families are scheduled to come onto Oracle Financials in April 2000. Remaining ministries will be phased-in to Oracle Financials over the fiscal year 2000/2001, and apparently are quite eager to do so. Once this is accomplished, the government will have a single, on-line mechanism for making payments and updating the general ledger. This will enable the government to work toward common business practices across the province.

Committee members also learned that the province of British Columbia has become a leader in implementation of Oracle Financials, and in fact in September 1999 presented three technical papers at an international Oracle users conference. Ontario and Quebec have followed the lead of British Columbia, and decided to use Oracle Financials for their financial management system as well. Currently, six out of ten Canadian provinces are using, or moving toward use of, Oracle Financials.

Some concern was expressed within the committee regarding that fact that Crown corporations in British Columbia are not actively converting to Oracle Financials software. The Comptroller General advised that Crown corporations are not currently part of the CAS operating environment due to the different business environment in which they operate. Therefore, while there have been discussions with some Crown corporations about using the software, the Office of the Comptroller General does not have a mandate to coordinate implementation of Oracle in Crown corporations.

Costs Incurred and Cost Savings Resulting from CAS Implementation

Your committee discussed the total cost of moving toward an integrated financial management system in British Columbia. Members were advised by the Comptroller General that the total cost of implementing CAS over the five-year period of the project is estimated at $75 million. However, this amount includes not only capital costs, such as the cost of various software licences relating to Oracle, but also all operating costs that would be incurred in any event (i.e. costs associated with maintaining and operating the existing Walker environment until the Oracle environment is fully in place, and the cost of upgrading the Oracle Financials system as required).

Concerns were raised within the committee about the ability of the government's financial management system to keep pace with rapid technological advances. In response to these concerns, the Comptroller General emphasized that the Oracle software was chosen because it is one of three leading systems currently available to governments, and is expected to continue to evolve along with governments' needs. He also noted that there are currently efforts to establish a Canadian provincial jurisdiction Oracle users group, which can provide input into the evolution of the Oracle product.

Finally, your committee was advised that once Oracle Financials is fully implemented, the province will save approximately $7.5 million per year in financial processes (based upon a 5% saving in administrative practices across ministries and corporate systems).

Internal Audit Branch Report

Committee members learned that the Internal Audit Branch ("IAB") of the Ministry of Finance and Corporate Relations conducted a review of work completed on the CAS initiative from November 1998 to January 1999, including the CAS Initiative Office and work done on the initial implementation of Oracle Financials at the ministries of Forests and Transportation and Highways (which was completed April 1, 1999).

The review focused on the General Ledger, Purchasing/Accounts Payable and Project Accounting modules of CAS. The adequacy of designed controls within the Oracle Financials environment to mitigate business risks such as unauthorized access to the system, unreliable information, and incorrect and invalid payments, was also reviewed.

While the review indicated that many controls exist within the systems design, some high-risk areas were identified and recommendations made as follows:

Security in the systems environment

The IAB recommended that:

- The CAS Initiative Office should consider using security features available in the Oracle software (such as encryption to protect the transmission of sensitive data), and should complete a threat and risk assessment to ensure sufficient controls are in place to minimize the risk of unauthorized access;
- The CAS Initiative Office and ministries should ensure all users are aware of effective password management and related security risks.

Application security

The IAB recommended that:

- The CAS Initiative Office and ministries should complete the design and testing of responsibilities (level of authority/access each user group has within Oracle Financials), request groups (who has access to which reports/utilities), assigned user access and flexfield security (to which General Ledger accounts users have access);
- Ministries ensure users understand their access responsibilities and the user management's responsibility to perform ongoing monitoring and review of key financial reports;
- The CAS Initiative Office consider providing some responsibility to ministries for creating, disabling and maintaining user-ID's and monitoring of activities performed by users.

Interfaces

The IAB recommended that:

- The CAS Initiative Office and ministries complete the design and testing of reports and processes to reconcile new and existing interfaces.

Payment authority customization

The IAB recommended that:

- The CAS Initiative Office should ensure that changes to invoice fields cannot be made after payment authorization and after payment has been made

- Until "locking" of invoice fields is in place, the CAS Initiative Office should track changes to key invoice fields after payment authorization, and report and review such changes on a daily basis before cheques are issued
- After "locking" is in place, the CAS Initiative Office should design a payment authority report to increase the efficiency of payment authority review

Committee members have been advised by representatives of the Internal Audit Branch that an action plan was developed by the CAS Initiative Office to respond to the risks identified in the review, and most recommendations had been implemented by the end of December, 1999.

Conclusion

The Auditor General's report states that, until all ministries in British Columbia are using a common financial application, opportunities for efficiency savings, better control over financial transactions, faster public reporting and efficiencies in business processes will not be achieved. In this regard, the Comptroller General has recommended that there be an accelerated 2-year implementation of Oracle across all remaining ministries. However, the Auditor General has emphasized that if momentum on CAS is to be maintained in the final stages of implementation, government must give priority to the human and financial resources which will be required to complete the project.

COMMITTEE RECOMMENDATIONS

2. Your committee endorses the Auditor General's recommendations relating to the Corporate Accounting System (CAS), contained in Part 3 of his 1999/2000 Report 2, Report on Government Financial Accountability for the 1997/98 Fiscal Year, and recommends that the CAS office should continue in its efforts to:

   (a) Formally sign an agreement with each ministry clearly outlining the responsibilities of each party for establishing and maintaining effective controls over data and processing, which agreement should include:

   - Responsibilities for access to encryption keys and for reviewing reports of the transactions submitted;
   - Division of responsibility between the ministry and CAS for ensuring the integrity and validity of the databases used by the CGI in its edit checks;
   - Division of responsibility between the ministry and CAS for reviewing all rejected batches and transactions reported, and resubmitting them, if appropriate;
   - Definition of the level of service to be provided by the CAS office to the ministries.

   (b) Ensure that changes to the CGI are authorized and documented, and then accepted by the users, in writing, before the changes are implemented.

   (c) Ensure that:

   - The CAS office's disaster recovery plan is consistent with the Office of the Comptroller General's Business Continuation Plan;
   - CAS office staff are trained in procedures to follow in case of a disaster or other business interruption;
   - The CAS office's disaster recovery plan is tested by the CAS office;
   - The CAS office, along with the Ministry of Finance and Corporate Relations, insist on and participate in regular testing of the Information Technology Services Division's disaster recovery plan.

3. Your committee recommends that this committee receive semi-annual updates on the status of implementation of the Corporate Accounting System, as well as the recommendations in this report.

Appendices

1 – Summary of Committee Recommendations

1. Your committee endorses the Auditor General's recommendations relating to the 1997/98 Public Accounts, contained in his *Report on Government Financial Accountability for the 1997/98 Fiscal Year, Part I, Report on the Public Accounts,* and recommends that the government:
   - Expedite recording in its financial statements the cost of land used for provincial buildings;
   - On a timely basis, develop a central database of relevant information on all land owned by the Province;
   - Provide ministries with clear and detailed guidance on accounting for the capitalization of land;
   - Provide ministries with adequate training to enable them to consistently apply guidelines on accounting for tangible capital assets;
   - In keeping with the substance of the agreement with PHH Vehicle Management Services Inc., account for the sales transaction as a capital lease, and record it as an asset and a liability in the Province's financial statements;
   - Develop guidelines to help government negotiators and the Comptroller General determine which costs incurred when creating a park should be capitalized and which should be charged to normal operations;
   - Include a reasonable estimate of post-retirement benefits as a liability in the Summary Financial Statements of the Province;
   - Account for all its liability for third-party insurance claims;
   - Account for payments to its organizations in a manner that reflects the substance of the transactions;
   - Include an appropriate note in the Province's financial statements and financial information it provides on health care to reflect the ownership of certain privately owned assets employed in providing health care services to British Columbians;
   - conduct a comprehensive review of accounting for school districts, with the purpose of improving their financial accountability.

2. Your committee endorses the Auditor General's recommendations relating to the Corporate Accounting System (CAS), contained in Part 3 of his 1999/2000 Report 2, Report on Government Financial Accountability for the 1997/98 Fiscal Year, and recommends that the CAS office should continue in its efforts to:

   (a) Formally sign an agreement with each ministry clearly outlining the responsibilities of each party for establishing and maintaining effective controls over data and processing, which agreement should include:

   - Responsibilities for access to encryption keys and for reviewing reports of the transactions submitted;
   - Division of responsibility between the ministry and CAS for ensuring the integrity and validity of the databases used by the CGI in its edit checks;
   - Division of responsibility between the ministry and CAS for reviewing all rejected batches and transactions reported, and resubmitting them, if appropriate;
   - Definition of the level of service to be provided by the CAS office to the ministries.

   (b) Ensure that changes to the CGI are authorized and documented, and then accepted by the users, in writing, before the changes are implemented.

   (c) Ensure that:

   - The CAS office's disaster recovery plan is consistent with the Office of the Comptroller General's Business Continuation Plan;
   - CAS office staff are trained in procedures to follow in case of a disaster or other business interruption;
   - The CAS office's disaster recovery plan is tested by the CAS office;
   - The CAS office, along with the Ministry of Finance and Corporate Relations, insist on and participate in regular testing of the Information Technology Services Division's disaster recovery plan.

3. Your committee recommends that this committee receive semi-annual updates on the status of implementation of the Corporate Accounting System, as well as the recommendations in this report.

II – WRITTEN SUBMISSIONS/CORRESPONDENCE AND RESEARCH DOCUMENTS

- Letter from Arn van Iersel, Comptroller General, to Rick Thorpe, Chair, Select Standing Committee on Public Accounts, dated January 5, 2000
- Ministry of Finance and Corporate Relations, Internal Audit Branch, "CAS/ORCA (Phase 1) Risk and Controls Review", January 1999
- Letter from Lawrie McFarlane, Secretary to Treasury Board, to Kelly Dunsdon, Committee Researcher, dated December 24, 1999, with attachments:
- "Provincial Cost in Fiscal 1999/00 of Provincial and Federal Revenue Measures Since 1996"
    - "Revenue and the Economy, 1995/96 – 199/00 Performance"
    - "Expenditure Management: 1995/96 – 1999/00 Performance"
    - "History of collective agreements with teachers 1995 to present"
    - "History of collective agreements with nurses 1995 to present"
    - "Public Sector Labour Costs Summary"
- Budget Process Review Panel, "Credibility, Transparency & Accountability: Improving the B.C. Budget Process", September 1999
- Ministry of Finance and Corporate Relations, "Presentation to Public Accounts Committee, October 26, 1999, Response to Auditor General's Recommendations"
- Office of the Auditor General, "Corporate Accounting System" (Presentation to the Select Standing Committee on Public Accounts, October 26, 1999)
- United States General Accounting Office, Report to the Secretary of the Treasury, "Financial Management Service: Significant Weaknesses in Computer Controls", October 1999